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OFFICE OF THE EXECUTIVE SECRETARY

April 24, 1998

Mr. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

Re: Application of Nashville Gas Company, a Division of Piedmont Natural Gas Company, for Approval to Defer Year 2000 Compliance Project Costs and for Establishment of a Regulated Asset Account for the Recovery of Such Costs in a Subsequent General Rate Case
Docket No. 98-00064

Dear Mr. Waddell:

I am enclosing for filing in the above captioned proceeding the original and fourteen copies of an Informational Filing of Nashville Gas Company. This filing was requested by the Authority at its April 21, 1998 conference. I would appreciate it if you would provide a copy of the filing to each Director.

I am enclosing an additional copy of the Informational Filing that I would appreciate your stamping "filed" and returning in the enclosed envelope.

Sincerely,

Jerry W. Amos

JWA:kam
Encl.

**Before The**
**Tennessee Regulatory Authority**
**Nashville, Tennessee**

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EXECUTIVE SECRETARY

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| Application of Nashville Gas Company, a Division of Piedmont Natural Gas Company, for Approval to Defer Year 2000 Costs and for Establishment of a Regulated Asset Account for the Recovery of Such Costs in a Subsequent General Rate Case | ) | Docket No. 98-00064 |

**<u>Informational Filing of Nashville Gas Company</u>**

Nashville Gas Company ("Nashville"), a division of Piedmont Natural Gas Company, Inc. ("Piedmont") hereby files the following information in response to the request made by the Tennessee Regulatory Authority ("Authority") at its April 21, 1998 Agenda Conference.

**I. <u>Background</u>.**

On or about January 31, 1998, Nashville filed a petition with the Authority seeking permission to (1) defer certain outside labor costs related to the repair of existing customer information and other systems to make the systems compliant with the Year 2000 ("Year 2000 Compliance Costs") and (2) to seek recovery of such costs in its next general rate case.

The accounting treatment sought in this application is similar to the accounting treatment approved by the Tennessee Public Service Commission (TPSC) in December 1992 in Docket No. 92-16160. In that docket, Nashville sought approval for the establishment of a regulatory asset account for environmental assessment and cleanup costs associated with the Company's manufactured gas plant sites. In its December 21, 1992 Order approving the requested accounting treatment, the Commission stated the following:

> "Authorizing past cleanup expenses as a regulatory asset does not mean the Commission will authorize the Company to recover all or part of these expenses from future rate payers. It simply says the Commission will consider this in a rate case when the Commission will have evidence

> concerning the total amount of the cleanup cost, who is responsible for the cleanup costs, and the fairness of passing this cost on to rate payers."

Nashville's request to defer Year 2000 Compliance Costs was placed on the agenda for the March 24, 1998 conference. At that time, the Authority asked several questions about a Nashville downsizing that resulted in 41 employees voluntarily terminating their employment with Nashville and 8 employees being involuntarily terminated. In order to give Nashville time to provide answers to those questions, Director Malone suggested that "we defer this matter to our next conference agenda, considering Director Kyle's line of questioning and your question, and give Nashville Gas the opportunity to get those figures in front of us, so we can weigh the layoff of the employees against what is requested here." Without object to the suggestion, the Authority deferred the matter to the April 7, 1998 conference.

On March 25, 1998, Nashville Gas requested that consideration of the matter be continued to the April 21, 1998 conference in order to give Nashville more time to provide appropriate answers to the Authority's questions and to avoid a conflict for Nashville's attorney.

The matter was again considered by the Authority at its April 21, 1998 conference. At that time Nashville, through its attorney:

- Presented a time-line showing the time relationship between the rate case which was filed on May 30, 1996 and the "layoff" of employees which occurred in November 1997, January 1998 and April 1998.
- Provided the answer to the question: "What is the immediate cost of the severance packages?" (The answer is "$1,182,311.")
- Provided the answer to the question: "What is the long-term effect of the savings to the annual budget?" (The answer is "approximately $500,000.")[1]

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1 Counsel also provided an explanation of how the "approximately $500,000" was calculated. The calculation of this amount is shown on Exhibit A to this filing.

- Provide the answer to the question: "Does Nashville Gas have any plans for further reductions in its work force during the next 12 to 18 months?" (The answer to that question is "No significant net reductions in work force are anticipated during the next 12 to 18 months.")

At the April 21, 1998 conference, several additional questions were asked and answered. These questions and answers follow:

- Will the planned $20 million additional investment in Nashville's service area require any new employees? (The answer is "These expenditures are primarily to put new pipe in the ground to serve customers. Although additional people in the Nashville area will be employed, they will be contract laborers and not employees of Nashville.")
- Is Piedmont downsizing employees in all three states in which it operates? (The answer is "Yes. There was a downsizing of employees in all three states.")
- Is it correct that approval of the request in this case would only permit a deferral of the Year 2000 costs and would not justify an increase in rates unless permitted by the Authority in a future rate case? (The answer is "Yes. Although Nashville could defer the costs on its books, it will not be able to recover these costs unless it files to seek recovery in a subsequent rate case and the Authority approves recovery of the costs in that rate case. Approval of the deferral request in this case will in no way prejudice the right of the Authority to allow or disallow those costs in a future rate case should recovery be sought.")
- Do you have any idea when the next rate case will be filed? (The answer is "If the GAP process works as intended, it will hopefully be a long time. Nashville's last case was filed in 1996, and it is possible that the next case could be delayed until the Year 2000. However, the answer to this question depends upon a lot of factors such as how much additional capital investment is required by Nashville to serve its

present and future customers. If Nashville is required to make large capital expenditures, it would have to file sooner.")

- If the City of Nashville keeps booming as it is, is it likely that a rate case could be filed sooner than 2000? (The answer is "It's possible, however, management is doing everything it can think of to avoid an earlier filing.")
- Is Nashville planning on putting the deferred costs in Miscellaneous Deferred Debits Account No. 186? (The answer is "Yes.")
- Is the Company under any kind of time restriction to get approval of its request? (The answer is "There is no specific time requirement; however, the Company must make filings with the Securities and Exchange Commission and with the financial community in which it must make certain disclosures as to how it intends to handle Year 2000 Compliance Costs. It will help the Company in dealing with investment bankers to get lower rates on debt issues and better prices for equity issues if it can report that its regulatory agencies have approved a process which at least gives the Company an opportunity to recover these costs.")

Following Nashville's presentation, the Authority determined that it would like information in writing. As a result, the matter was continued to the Authority's next conference, and Nashville was requested to provide the information in writing. The purpose of this filing is to comply with the Authority's request for written information.

## II. <u>Customer Additions</u>.

Both Piedmont and Nashville have been adding customers at a rate that is more than three (3) times the national average.[2] Although the addition of these customers has been good for the city of Nashville and the other communities being served by Piedmont and Nashville, it has resulted in substantial increases in expenses and has required Piedmont to raise substantial capital. Since rates

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2 Nashville has added in excess of 6,000 customers in each of the past three fiscal years.

are based on embedded costs (which are less than current costs) and since some capital expenditures (such as system strengthening) do not produce any additional revenues, the total revenue resulting from these capital expenditures is not sufficient to offset the additional costs. As a result, Piedmont and Nashville have had to file periodic rate cases.

**III. <u>Nashville's Last General Rate Case.</u>**

Nashville's most recent rate case was filed on May 30, 1996. It was based on information available to Nashville at that time, consisting primarily of actual financial information for the 12-months ended December 31, 1995 (the "Test Period") and estimates of revenue, expenses and rate base for the 12-months ended October 31, 1997 (the "Attrition Period").

In its general rate case petition, Nashville pointed out that:

> "Nashville Gas' inability to earn a fair and reasonable return on its investment results from a number of factors, including the following:
>
> a. Since its rates were last increased, Nashville Gas has invested $47.5 million in new plant and facilities to serve its customers, including more than 11,800 customers who have been added since that date.
>
> b. Since its rates were last increased, Nashville Gas has been required to acquire additional capital to enable it to improve and extend its natural gas services to its customers.
>
> c. Since its rates were last increased, Nashville Gas' expenses have increased because of the need to offer improved and expanded service to new and existing customers."

During the course of the hearing, both the Consumer Advocate and Associated Valley Industrial Intervention Group ("AVI") recognized that Piedmont's need for filing periodic rate cases resulted from the capital expenditures and expenses associated with the addition of new customers and services.[3]

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3 *See*, Docket No. 96-00977, Transcript Vol. I, pp. 47-49 and Vol. II, p. 146.

Nashville's rate case was heard on November 13 and 14, 1996, and new rates became effective on January 1, 1997.[4]

**IV. GAP.**

In March 1997, Piedmont and Nashville received their financial results for the calendar year ended December 31, 1996. Of course, this information was not available when the rate case was filed in May of 1996 or when the rate case was heard in November 1996. Based on this latest financial information and projections of future rate base, revenue and expenses, it was determined that Piedmont and Nashville would have to either (a) reduce their capital investments in new facilities and services or (b) continue to file repeated rate cases unless some method was found for reducing expenses. It was for this reason that the GAP process was begun. ("GAP" refers to the difference between (x) the income that would be required to permit Piedmont and Nashville to continue to raise the necessary capital for future customer additions and (y) the income that would actually be produced without either an increase in revenue through rate cases or a decrease in expenses.)

The GAP process involved a solicitation of suggestions from all employees, a consideration of those suggestions by various "teams" of employees from all levels, a review and approval of various suggestions by senior management, and, finally, consideration of the final recommendations by the Board of Directors. Among the many suggestions made and adopted was the recommendation that the work force be reduced by eliminating non-essential positions and by consolidating various work functions where such consolidation would not adversely affect customer service. It was also recommended that, when possible, any reduction in work force be obtained through voluntary terminations and that financial incentives be offered to obtain these voluntary terminations and to eliminate or lessen any financial burdens for the terminated employees.

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4 The case is presently on appeal to the Court of Appeals for the Middle Section of Tennessee (Appeal No. 01A01-9708-BC-00391).

The final GAP recommendations were adopted by the board of directors in August 1997. The first terminations of employees occurred in November 1997 and continued through February 1998. It should be noted that the first termination of employees occurred more than 18 months after the filing of the rate case and that none of these terminations occurred either within the Test Period or the Attrition Period used in the rate case.

A summary of the GAP process as described in Piedmont's 1997 Annual Report to Shareholders is attached as Exhibit B. This Report, prepared and mailed to shareholders long before the Authority initiated its inquiries in the instant case, confirms the reasons for, the timing of, and the desirable results obtained from the GAP process. Included in these desirable results is "the elimination of planned rate case filings in 1997." This Report confirms the value of the GAP process to Nashville's customers.

## V. Relief Being Sought in the Year 2000 Compliance Petition.

In this docket, Nashville is not seeking any increase in rates. It is simply seeking authority to defer its Year 2000 Compliance Costs until its next rate case, at which time Nashville may or may not seek recovery of the costs. If Nashville should seek to recover some or all of its Year 2000 Compliance Costs in a future rate case, the Authority can determine at that time whether recovery is appropriate. Granting the relief sought in this petition does not prejudice the Authority or any other person in any way.

## VI. Additional Information in Response to the Authority's Questions.

It is Nashville's intent that the information previously provided to the Authority when combined with the following information fully and completely respond to all of the Authority's questions and concerns. In the event that it does not, Nashville will supply additional information upon request.

## A. <u>Is there a connection between the employee terminations under GAP and Nashville's last rate case</u>?

Apparently there is some concern that Nashville included payroll expenses in its rate case knowing that it would subsequently reduce its work force and its future payroll expenses. If so, the following should alleviate that concern.

- During the rate case, there was simply no way Nashville could have known that a reduction in work force would be proposed, much less approved. As shown by the chart handed out at the April 21, 1998 conference, the GAP process was not even begun until after the conclusion of the rate case, and no reductions in work force was approved until 10 months after the hearing of the rate case.
- If Nashville had known about the reduction in work force and related incentive payments during the rate case (and it did not), it would have been in Nashville's best interest to disclose that information to the Authority. In Nashville's rate case, rates were established on the basis of the Attrition Period.[5] The reduction in work force did not take place until after the Attrition Period. Thus, if during the rate case, Nashville had known that a reduction in work force would take place after the end of the Attrition Period, it would not have lowered the payroll costs during the Attrition Period. In fact, the exact opposite would have been true. Although none of the 48 employees were terminated during the Attrition Period, Nashville made incentive payments of $1,182,311 during the Attrition Period to the employees who were terminated after the Attrition Period. Thus, if Nashville had known that employees were to be terminated after the Attrition Period and that incentive payments would have been made during the Attrition Period, Nashville could have

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5 The use of a forward-looking attrition period is required by the Tennessee Supreme Court. *See, South Central Bell Telephone Company v. Tennessee Public Service Commission*, 579 S.W.2d 429 (1979).

sought to recover the incentive payments without any offsetting reductions in payroll expenses. It did not do so.[6]

- If the Authority is concerned that it may have allowed the recovery of excessive payroll costs in the rate case, it need not have this concern. Actual payroll costs during the Attrition Period were higher than the amount allowed by the Authority.[7]
- If the Authority is concerned that the approved rates will permit Nashville to earn more than allowed, it need not have this concern. Nashville earned less than its allowed return during the Attrition Period.[8]
- If the Authority is concerned that the reduction in work force was timed to follow the rate case for some nefarious purpose, it need not have this concern. A review of Nashville Gas' past rate cases will show that it would be impossible for Nashville to effect a reduction in work force that did not closely follow a rate case. Nashville filed rate cases and received rate increases in 1987, 1989, 1991, 1994 and 1996.[9] Thus, any reduction in work force at any time during the past 10 years would have closely followed a rate case. Furthermore, even if Nashville had timed the reduction in work force for some nefarious purpose (and it did not), that purpose would not

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6 Nashville recognizes that had it sought recovery of the incentive payments, it may have been determined that the appropriate rate making treatment would be to amortize the payments over some period of time. Although amortization would reduce the benefit to Nashville, it would not eliminate it.

7 The Authority allowed payroll expense of $14,640,311. Actual Attrition Period payroll expenses were $15,782,104. Even if the incentive payments are totally excluded from actual payroll expenses, the actual payroll expenses were only $40,518 (3/10th of 1%) less than allowed by the Authority.

8 The Authority allowed an overall return of 9.85%. During the Attrition Period, Nashville's actual overall rate of return was 9.74% as reported on the Company's Form 3.03 for the 12 months ended October 31, 1997.

9 See Docket Numbers U-87-7499, U-89-10491, 91-02636, 94-01054 and 96-00977.

have been achieved. As shown above, Nashville has not had excessive earnings. To the contrary, its earnings during the Attrition Period were less than it was allowed in the rate case.

The GAP process and accompanying reduction in work force was not implemented to produce excess earnings (and it has not done so). It was implemented to delay the filing of future rate cases. Nashville assumes that the Authority wants it to reduce expenses whenever it is possible to do so without adversely affecting customer additions and customer service. That is precisely what the GAP process is all about.

**B. <u>Will customer service be affected by the reduction in work force</u>?**

Customer service will not be affected by the reduction in work force. Fifteen of the terminated employees were involved in marketing and sales activities. Three of the terminated employees were executive secretaries. Three of the terminated employees performed accounting functions. One of the terminated employees was a legal analyst. Two of the employees were gas controllers, and all gas control functions are now handled by an automated process in the home office. Three of the terminated employees handled customer calls, and those functions are now handled by personnel in the home office. To the extent that any of the remaining terminated employees performed customer service functions, those functions have been consolidated and are being performed by other employees.

**C. <u>Were the terminated employees fairly treated</u>?**

A total of 49 employees were terminated. Forty-one of these employees elected voluntarily termination. The remaining eight employees were given attractive economic financial packages. Nashville set up a "career center" for all terminated employees to help them obtain new jobs. The career center offered expert advice of how to prepare resumes, how to interview, and how to find career opportunities. At the present time, the country is facing the lowest unemployment level in many years, and skilled employees have no problem finding attractive job opportunities. In short, Piedmont and Nashville purposely timed the terminations during a period when the terminated employees would not suffer substantial adverse consequences.[10]

### D. <u>Why does Nashville need the Authority to approve a deferral now?</u>

Rules of the Securities and Exchange Commission require Piedmont to provide information to its shareholders and to potential investors as to whether or not Year 2000 Compliance costs could have an material adverse effect on Piedmont's earnings.[11] If the Authority approves Nashville's request for deferred treatment of these costs, Piedmont will be able to state that the costs are being deferred with the possibility of future recovery. Although this will not entirely eliminate the possible adverse effect of these expenditures, it is believed that it will provide sufficient assurances to potential investors to prevent them from unnecessarily increasing Piedmont's cost of capital. Since rates are ultimately affected by the cost of capital, Nashville believes approval of its request in this docket can reasonably be expected to reduce Nashville's cost of capital as compared with what it would be if the request were to be denied.

### E. <u>Is Nashville's request to defer Year 2000 Compliance Costs in any way connected with the termination of employees?</u>

To Nashville's knowledge, no one has suggested any specific relationship between its request in this docket to defer Year 2000 Compliance Costs and the termination of employees. Nevertheless, since the Authority has chosen this docket to raise the termination issue, it seems fair to assume that someone thinks there is some kind of relationship. Nashville respectfully suggests that no such relationship exists.

The only possible relationship that Nashville can imagine is that someone believes that the termination of employees will produce excess earnings that can be used to pay the Year 2000

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[10] Although this section focuses on the terminated employees, Nashville is also concerned about the ability of its service area to attract new industries and, thereby, to create new jobs. The action taken by Nashville will help keep its gas rates reasonable, attract new industries and provide new jobs.

[11] *See*, SEC Staff Legal Bulletin Number 5, a copy of which is attached as Exhibit C.

Compliance Costs. For the reasons stated above, Nashville does not believe this possibility exists. But even if it did, it would not provide justification for denying a request to defer the Year 2000 Compliance Costs. Deferral of these cost will not increase any rates at this time. If Nashville should seek to recover these costs in a future rate case and if it should appear that the termination of employees produced excess earnings, the Authority could simply refuse to permit Nashville to recover the deferred costs. Stated another way, the Authority does not have to guess the effect of its past rate order or of the employee terminations when it determines whether Nashville is entitled to recover any of its Year 2000 Compliance Costs, it can simply approve deferral of the costs now and make its decision as to whether recovery is appropriate at a future date when all of the facts are known. In that manner, the Authority's decision would be based on known facts rather than on speculation.

**VII. <u>Conclusion.</u>**

In conclusion, Nashville has taken action under its GAP process designed to avoid future rate increases. Nashville believed at the time and continues to believe that this action is in the best interest of its ratepayers and that it is consistent with the objective of the Authority to keep rates as low as possible. The action taken by Nashville was designed and timed to place a minimum burden on the terminated employees, and, apparently, 41 of the 49 employees in question agreed since they took voluntary termination. The remaining eight employees were fairly compensated and as a result of current conditions in the work force should have no problem in finding employment elsewhere.

Nashville did not know at the time of its last rate case that the terminations would occur and, even if it had, disclosure of that fact would not have provided a basis for reducing the amount of the allowed rate increase. During the Attrition Period, Nashville did not even earn its allowed overall return, much less have excessive earnings. Therefore, there is no reason for the Authority to suspect any nefarious motives.

Finally, the granting of the requested deferred accounting treatment will not result in any rate increase at this time, will never result in a rate increase unless the Authority at some later date determines that a rate increase is appropriate, and could help reduce Piedmont's costs of capital and ultimately rates.

For all of the above reasons, Nashville respectfully requests the Authority to approve its requested deferred accounting treatment.

Respectfully submitted this the ___ day of April, 1998.

Nashville Gas Company, a Division of
Piedmont Natural Gas Company, Inc.

By: Paul C. Gibson
Paul C. Gibson
Vice President - Rates

| | | | |
|---|---|---|---|
| Payroll Savings | | $2,639,915 | |
| Less:<br>Cost to perform functions trans ferred from terminated employees | | (410,000) | |
| Return for additional plant ($20,000,000 x .1340) | $2,680,000 | | (1) |
| Less anticipated revenue from additional plant | 2,400,000 | (280,000) | |
| Additional Expenses to serve new and current customers | | (1,437,557) | |
| **Net Projected Reduction in 1998 Expenses** | | **$512,358** | (2) |

(1) .1340 is the pre-tax return allowed in Docket No. 96-00977

(2) Expenses are projected to increase again in 1999 as new customers are added, and wages and other expenses are increased due to inflation.

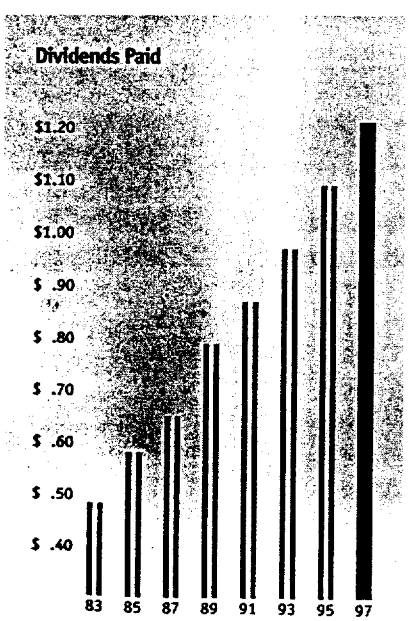
approved three such major projects. As previously reported, the FERC approved the 4 Bcf Pine Needle LNG Company, L.L.C. (Pine Needle), liquefied natural gas project, in which a company subsidiary has a 35% equity interest. The Company has also subscribed to 50% of the project's vaporization capability. Construction of the project has begun and service is scheduled for the 1999-2000 winter period. In addition, the FERC approved Transcontinental Gas Pipe Line Corporation's (Transco) SunBelt expansion project, which began service to the Company in November 1997, and Columbia Gas Transmission Corporation's (Columbia) storage project. The Columbia project also began partial service in November 1997 and will offer expanded service to the Company beginning November 1, 1998.

The financial results of the Company's largest non-regulated business, the sale of propane to over 48,000 customers in the Carolinas and Tennessee, were affected by warmer-than-normal weather during the 1996-1997 winter period. Revenues decreased to $36.8 million and gallons sold to 36.7 million. The Propane Division continued its acquisition strategy with one Tennessee and one North Carolina propane company acquired during the year. With normal weather conditions, it is anticipated that this division will increase its contribution to Company earnings in 1998.

Resource Energy Services Company, L.L.C. (Resource Energy), a non-utility natural gas marketer of which the Company is the majority member, continued its activities through its Houston and [illegible]

Early in 1997, the Company set out to reorganize its corporate goals and planning strategies. The results of this Company-wide effort were presented to the Board of Directors in August and were introduced to employees in September. While the strategies include present and future plans to ensure the Company's ability to grow and prosper in a changing business environment, initial efforts focused on our core utility business. The results were impressive. Over 2,000 employee suggestions on ways to become more efficient, to better serve our customers and to generate increased shareholder value were received and evaluated. As a result of implementing proposals relating to every area of the Company's operations – from regionalization of our district business offices and outsourcing our main-frame computer center to overtime and expense reductions – we achieved a major objective. The second, more difficult step required to reach the goals set forth in our new business plan was the reduction in personnel. Our workforce has been reduced through a Special Event Voluntary Severance Plan and by not filling certain vacant positions. While this program resulted in a $1.8 million or $0.04 per share write-off in 1997, it will show significant benefits in the future.

The steps taken to strengthen our core utility business have had an immediate effect on our operations. Major changes include the canceling of a planned fall 1997 equity financing, the elimination of planned rate case filings in 1997, and possibly 1998, and making major reductions in operating and maintenance expenses – without compromising our customer growth or competitive position – while continuing our goal of increasing shareholder value.




Now that our core business focus has begun what will be an ongoing process of streamlining operations and redefining utility customer services, our other strategies to produce earnings growth are being addressed. They include building market share with new marketing programs and new gas-fired equipment technology and, as market and regulations permit, expanding our non-regulated retail energy sales and service opportunities in the southeast.

In past Annual Report letters to shareholders, I have discussed the changing utility industry and how your Company has been preparing for that change. This past year has seen the entire energy industry, from the producer or generator of energy to the end user, become more involved in what is now a major restructuring. Acquisition and/or merger announcements were

Exhibit C

# Staff Legal Bulletin No. 5 (CF/IM)

*Revised January 12, 1998*

**Action:** Publication of Divisions of Corporation Finance and Investment Management Staff Legal Bulletin

**Summary:** The Divisions remind public operating companies, investment advisers, and investment companies to consider their disclosure obligations relating to anticipated costs, problems and uncertainties associated with the Year 2000 issue. This Bulletin, originally issued on October 8, 1997, is revised to provide more specific guidance under the existing Commission rules and regulations due to the importance of the Year 2000 issue and some uncertainty expressed by members of the accounting and legal professions regarding what should be disclosed.[1]

**Supplementary Information:** This legal bulletin represents the Divisions' staff views. This bulletin is not a rule, regulation, or statement of the Securities and Exchange Commission. Further, the Commission has not approved or disapproved its content.

**Contact Person:** For further information, please contact Broc Romanek regarding public operating companies at (202) 942-2900 and Anthony Vertuno regarding investment companies and investment advisers at (202) 942-0591.

## I. The Year 2000 Issue

Many existing computer programs use only two digits to identify a year in the date field. These programs were designed and developed without considering the impact of the upcoming change in the century. If not corrected, many computer applications could fail or create erroneous results by or at the Year 2000. The Year 2000 issue affects virtually all companies and organizations.[2]

## II. Disclosure by Public Companies Regarding the Year 2000 Issue

Many companies must undertake major projects to address the Year 2000 issue. Each company's potential costs and uncertainties will depend on a number of factors, including its software and hardware and the nature of its industry. Companies also must coordinate with other entities with which they electronically interact, both domestically and globally, including suppliers, customers, creditors, borrowers, and financial service organizations. If a company does not successfully address its Year 2000 issues, it may face material adverse consequences. Companies should review, on an ongoing basis, whether they need to disclose anticipated costs, problems and uncertainties associated with Year 2000 consequences, particularly in their filings with the Commission. Public companies may have to disclose this information in Commission filings because:

- the form or report may require the disclosure, or
- in addition to the information that the company is specifically required to disclose, the disclosure rules require disclosure of any additional material information necessary to make the required disclosure not misleading.[3]

The following is a discussion of certain requirements.

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

Companies should include disclosure in their "Management's Discussion and Analysis of Financial Condition and Results of Operations" [4] if:

- the cost of addressing the Year 2000 issue is a material event or uncertainty that would cause reported financial information not to be necessarily indicative of future operating results or financial condition, or

- the costs or the consequences of incomplete or untimely resolution of their Year 2000 issue represent a known material event or uncertainty that is reasonably expected to affect their future financial results, or cause their reported financial information not to be necessarily indicative of future operating results or future financial condition.

**Description of Business**

If Year 2000 issues materially affect a company's products, services, or competitive conditions, companies may need to disclose this in their "Description of Business."[5] In determining whether to include disclosure, companies should consider the effects of the Year 2000 issue on each of their reportable segments.

**Form 8-K**

A company's Year 2000 costs or consequences may reach a level of importance that prompts it to consider filing a Form 8-K. At their option, companies would file these reports under Item 5 of Form 8-K. In considering whether to file a Form 8-K, companies should be particularly mindful of the accuracy and completeness of information in registration statements filed under the Securities Act that incorporate by reference Exchange Act reports, including Form 8-Ks.[6]

**Accounting Considerations**

The Emerging Issues Task Force considered the issue of how to properly reflect the costs of modifying computer software for Year 2000 projects in the financial statements. In July 1996, the EITF concluded that these costs should be charged to expense as they are incurred.[7]

**Specific Disclosure Considerations**

If a company determines that it should make Year 2000 disclosure, the applicable rules or regulations should be followed. If a company has not made an assessment of its Year 2000 issues or has not determined whether it has material Year 2000 issues, the staff believes that disclosure of this known uncertainty is required. In addition, the staff believes that the determination as to whether a company's Year 2000 issues should be disclosed should be based on whether the Year 2000 issues are material to a company's business, operations, or financial condition, without regard to related countervailing circumstances (such as Year 2000 remediation programs or contingency plans). If the Year 2000 issues are determined to be material, without regard to countervailing circumstances, the nature and potential impact of the Year 2000 issues as well as the countervailing circumstances should be disclosed. As part of this disclosure, the staff expects, at the least, the following topics will be addressed:

- the company's general plans to address the Year 2000 issues relating to its business, its operations (including operating systems) and, if material, its relationships with customers, suppliers, and other constituents; and its timetable for carrying out those plans; and

- the total dollar amount that the company estimates will be spent to remediate its Year 2000 issues, if such amount is expected to be material to the company's business, operations or financial condition, and any material impact these expenditures are expected to have on the company's results of operations, liquidity and capital resources.

The disclosure must be reasonably specific and meaningful, rather than standard boilerplate.

**Foreign Companies**

Foreign private issuers also should follow this guidance. In particular, these issuers should consider the disclosure requirements of Form 20-F, Item 1 ("Description of Business") and Item 9 ("Management's Discussion and Analysis of Financial Condition and Results of Operations").

## III. Disclosure by Investment Companies and Investment Advisers Regarding the Year 2000 Issue

Under the Investment Advisers Act of 1940 and the Investment Company Act of 1940, investment advisers and investment companies may be required to make appropriate disclosure to clients and shareholders if operational or financial obstacles are presented by the Year 2000 issue. Disclosure of the Year 2000 issue is necessary if it is materially misleading to shareholders to omit the information.

The Investment Company Act provides that it is unlawful for investment companies to omit from registration statements and other public filings "any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they were made, from being materially misleading."[8] Open-end investment companies ("mutual funds") are required by Item 5(b) of Form N-1A to describe in their registration statements the experience of their investment advisers and the services that the advisers provide. In response to this item, investment companies may need to disclose the effect that the Year 2000 issue would have on their advisers' ability to provide the services described in their registration statements.

The anti-fraud provisions of the Investment Advisers Act generally impose on investment advisers an affirmative duty, consistent with their fiduciary obligations, to disclose to clients or prospective clients, material facts concerning their advisory or proposed advisory relationships.[9] If the failure to address the Year 2000 issue could materially affect the advisory services provided to clients, an adviser that will not be able to or is uncertain about its ability to address Year 2000 issues has an obligation to disclose such information to its clients and prospective clients. This disclosure must be made in a timely manner so that the clients and prospective clients may take steps to protect their interests.

Investment companies and investment advisers that determine that Year 2000 disclosure is required also should follow the guidelines under "Specific Disclosure Considerations" discussed above.

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***Footnotes***

Exhibit C

1 Recently, Senate Financial Services and Technology Subcommittee Chairman Robert Bennett introduced legislation, the Year 2000 Computer Remediation and Shareholder Protection Act of 1997 (S.1518).

2 In a June 1997 report to Congress, the Commission noted the readiness of the securities industry and public companies to meet the challenges of the Year 2000 issue. This report is available on the Commission's web site at http://www.sec.gov/news/studies/yr2000.htm.

3 Securities Act Rule 408, Exchange Act Rule 12b-20, and Exchange Act Rule 14a-9. Companies also should consider the anti-fraud provisions of the Securities Act and the Exchange Act. These anti-fraud requirements apply to statements and omissions both in Commission filings and outside of Commission's filings. Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5.

4 Item 303 of Regulations S-K and S-B. The Commission provided interpretive guidance regarding the disclosure required by Item 303 in Securities Act Release No. 6835.

5 Item 101 of Regulations S-K and S-B.

6 General Instruction B.4 of Form 8-K.

7 Emerging Issues Task Force of the Financial Accounting Standards Board Issue No. 96-14: Accounting for the Costs Associated with Modifying Computer Software for the Year 2000, July 18, 1996.

8 Section 34(b) of the Investment Company Act of 1940.

9 Sections 206(1) and (2) of the Investment Advisers Act of 1940. See SEC v. Capital Gains Research Bureau, Inc. 375 U.S. 180 (1963).

*http://www.sec.gov/rules/othern/slbcf5.htm*
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